

# GWD

*Gases & Welding Distributor*

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## Opportunity Knocks in **Niche Markets**

Executive Perspective:

**Peter McCausland**  
**Airgas, Inc.**



# Airgas Stresses the Basics in 2004

Ron Lucas, *Managing Editor*

With annual sales of \$1.8 billion and a network of almost 800 locations, Airgas, Inc. ranks as the largest U.S. distributor of industrial, medical, and specialty gases, welding and safety and related products in the U.S. The firm has grown consistently over the last 20 years, making more than 300 acquisitions. **Airgas Chairman and CEO Peter McCausland** recently consented to an exclusive interview with *GWD* to provide our readers with his views on the economy, the gases and welding industry, and his firm's overall strategy for 2004.

**GWD:** *Airgas has made more than 300 acquisitions over the last 20 years. Tell us about those made in 2003.*

**McCausland:** Less than 18 months ago, we acquired Air Products' U.S. cylinder gas business. That was the largest acquisition Airgas had ever made. We spent a good part of the next 12 months on the integration. We also made four additional acquisitions before our fiscal year ended on March 31, 2003. The two most notable were Welding Metals, a Detroit-based distributor with \$10



**Airgas Chairman and CEO Peter McCausland**

million in annual sales, and Union Industrial Gases with 14 branches in Florida, Georgia, and California and annual sales of \$20 million. Those were important to us because of their size, and because they filled in some gaps in our national network.

**GWD:** *How do you select your targets for acquisition?*

**McCausland:** We target markets where we have gaps in our network. In addition, there are also certain parts of the country where we would like to have more density, such as Northern Florida-Southern Georgia or the Detroit area, where we made these recent acquisitions. We don't have as much interest in acquiring distributorships located in



areas where we already have sufficient coverage.

**GWD: Do you make product acquisitions as well?**

**McCausland:** Yes, we do. We make those decisions on a market-by-market basis. Since the start of our fiscal year in April, for example, we bought a company called Delta Safety in Stockton, CA, with sales of \$9 million, adding it to our Airgas Northern California and Nevada region. We are one of the largest distributors of safety equipment in the U.S., but we still have room to grow. And, in this particular market, we felt that the best way to grow was to do an acquisition of a strong regional safety distributor. We also made a dry ice acquisition this year as well.

**GWD: Why dry ice?**

**McCausland:** We are the leading producer and distributor of dry ice in the U.S. It's a good product line for us. It's grown fairly rapidly because most applications are for food, beverage, recreation, and medical research — all areas with faster growth than the manufacturing sector in this economy.

**GWD: Do you plan to make acquisitions in 2004?**

**McCausland:** Yes, we believe integrating acquisitions is a core competency for Airgas, and we expect to have plenty of opportunities next year because the forces in the market will continue to drive consolidation. Things can always change, of course — tax policy, the economy, personal



Airgas has 195 cylinder filling plants nationwide. Many, like this one in Cheshire, CT, are palletized fast-fill operations.



**Airgas regional companies and 34 Puritan Medical Products branches nationwide had combined annual medical gas sales of \$120 million in the fiscal year ended March 31, 2003.**

circumstances — but I haven't seen the prospects this good for a long time.

**GWD: Why do conditions appear so favorable at present?**

**McCausland:** There were significantly fewer sales of independent distributorships during the last five years compared to previous years and my feeling is that the poor industrial economy had a negative effect on sales. Independents don't like to sell after a few bad years. They would rather wait until the economy recovers.

However, we have had such a prolonged slump, there seems to be a fair amount of pent-up demand. Some independents now believe they may not do much better when the market does finally come back. Others think that

the manufacturing market might stay flat awhile. We are seeing a lot more activity and fully expect next year will be a good one for acquisitions.

**GWD: Are these largely opportunity buys?**

**McCausland:** With our national network we can serve all our national accounts and regions without any further acquisitions. That puts us in a good position — we don't have to stretch for deals. So, to that extent, we are an opportunistic buyer. On the other hand, we still like to make acquisitions and are good at it. We can also enjoy a number of side benefits. For example, in addition to more sales, profits, cylinders, and facilities, we also pick up some good people and programs. We've found that some of our best talent and our best

ideas come to us from acquisitions.

**GWD: What types of market forces drive consolidation?**

**McCausland:** I think that a number of forces that drive consolidation have intensified over the last couple of years. The cost of business insurance skyrocketed after 9/11. After a few years of relative calm, the cost of health insurance has also begun to skyrocket. Litigation is out of control and workmen's compensation is on the rise. Finally, the FDA, OSHA, and other regulatory bodies are increasing the scope of their efforts. Of course, one of the most important market factors is the economy — it's really tough out there and the recovery we've all been waiting for always seems to be about two quarters away.

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However, there are other forces driving consolidation as well. Customers are increasingly looking for distributors that offer broad geographic coverage so they can quickly service all their facilities. They want distributors that offer an extensive product line that enables them to reduce their vendor base and associated transaction costs. And they look for distributors willing to make investments in electronic commerce, logistical infrastructure, filling technology, safety programs, and technical support, because those features help

them wring out even more cost. So at the end of the day, it's customer demands and cost pressures that are the primary drivers of consolidation.

**GWD:** *You mentioned rising healthcare costs. That's a concern to many businesses today. What do you see as the root cause?*

**McCausland:** Any system in which the person paying for a service is not the one who is actually using it is bound to experience inflationary pressures. That situation has been somewhat remedied over the last few years as employers have shifted more of the cost of healthcare to employees, who are the healthcare consumers. That's helped, but the HMO's have squeezed the providers for years and now the pendulum is swinging the other way. Remember, Americans demand a high level of healthcare and are not about to settle for less. But those new technologies and treatments help drive inflation. Then, too, everybody wants all those latest facilities in their own back yard. As a result, healthcare facilities haven't rationalized costs like



other industries and we are now experiencing double-digit increases projected out for several more years.

**GWD:** *What is Airgas doing about healthcare costs?*

**McCausland:** We are absorbing the healthcare expense and trying to

reduce administrative costs by introducing new technology to make enrollment a paperless process. We also provide our employees with a variety of choices in terms of coverage and deductibles, so they can pick the plan most appropriate for them and avoid over-coverage. Our employees have always shared the cost of our healthcare expense, but when we had successive years of double-digit increases, the company would bear a little more of the cost, and bring it back into equilibrium when the pressure subsided. Overall, I think we've done a pretty good job of managing it, although admittedly it's a little easier for us with nearly 9,000 employees compared to an employer with a much smaller group.

**GWD:** *What kind of solution would you like to see on a national basis?*

**McCausland:** I don't think there should be a national solution. The market will take care of it. Every time we attempt a national solution, the bureaucracy messes it up. It's hard to run anything by committee. Even trade groups have sponsored healthcare plans without much success.

If we were part of a trade organization's plan, I know we wouldn't be able to make flexible decisions. For example, there are a lot of regional differences in terms of availability and cost. I know because we have had to deal with them. So how can a distributor located in a region with a limited number of expensive options pay the same for associates as a distributor out in a region with strong HMO competition and lower costs? I just don't see how these differences can be accommodated in any trade group sponsored plan.

**GWD:** *Acquisitions are clearly one component of your firm's overall strategy. What are some of the others?*

**McCausland:** Our financial goal is to reach \$2 billion in sales and at least a 10 percent operating margin by the end of fiscal 2005. We expect to reach



**Airgas has the largest cylinder delivery fleet in the Compressed Gas Association. It has won the fleet safety award in its category for the last two years.**



**“Our financial goal is to reach \$2 billion in sales and at least a 10 percent operating margin by the end of fiscal 2005.”**

those numbers by following through on our overall strategy. One component of that strategy is to focus on growth areas in our business. Those include our strategic accounts program, medical gases, specialty gases, CO<sub>2</sub> and dry ice, Red-D-Arc welder rentals, and safety products. These niches are not only growing faster, but many of them represent sales to the service sector of the economy. With the manufacturing sector in long-term decline, we think this is extremely important. At this point, about 20 percent of our sales come from the service sector where we have gained a lot of momentum in the last few years.

Perhaps the most important component of our strategy this year will be a re-dedication to our core business — the small- and medium-sized welding customers. These are firms with up to 100 employees that buy welding equipment, gases, and safety equipment. With the heavy emphasis on consolidation in the past, these customers were sometimes neglected. Now, with our national network firmly in place, we have the luxury of performing acquisitions in a more methodical way. We can return to our roots and enhance that core business.

We plan to expand E-commerce, increase staff, add stores, improve store inventory, add products, and do some promotions and direct marketing to reach these traditional customers. But most of all, it means a re-dedication to making the buying experience for these customers as good as it possibly can be.

All of our managers are excited. We are putting together a task force to follow through with this initiative. It includes local people like store man-

agers, welding specialists, and individuals from the regional and corporate levels. We'll start to roll out parts of this new program by the end of 2003.

**GWD: Do bulk gases play a role in that strategy?**

**McCausland:** Yes. It's one of our strategic products. We have large volumes and good distribution capabilities that allow us to grow that part of the business fairly well. We serve a broad spectrum of the bulk business, but the majority is in the small bulk category — up to 3,000 gallons. We also have mini-bulk capabilities now in nine different parts of the country.

I see plenty of bulk gas opportunities for us out there with small and medium customers. Large gas producers have pretty much focused on the large bulk market — 6,000 gallon tanks and larger. They simply don't have the sales coverage to focus on the smaller customers. Furthermore, our strategic accounts program, which uses the sole sourcing concept, allows us to pull in the bulk business along with other sales. We can serve our customers with a variety of delivery modes from cylinders to bulk deliveries and provide other products, such as specialty gases, dry ice, and safety products.

**GWD: Are there any other initiatives now underway?**

**McCausland:** Over the last few years we've centralized our purchasing from more than forty locations into four buying centers and installed Manugistics software. We continue to build our logistical infrastructure so our five distribution centers are now functioning at a high level. We are building a new fill plant in Los Angeles, and we just completed a new CO<sub>2</sub> plant in Hopewell, VA.

**GWD: What kind of management team is in place to meet your goals?**

**McCausland:** We have strong local leadership teams formed from a com-

bination of those who came to Airgas through acquisitions and those we recruited. They are entrepreneurial self-starters who like to work hard, take the ball and run. We've given them lots of autonomy and empowered them to respond to local needs. And in recent years, we have added strong functional leadership to support our local leaders. The combination seems to be working well.

**GWD: Airgas launched a formal process to promote leadership. Can you describe that effort?**

**McCausland:** As we started to approach sales of \$2 billion, I felt like we needed to identify the factors that were responsible for our success so we could ensure that we fostered them as we continued to evolve. I asked the top 40 managers in the company to attend a retreat for a couple of days. There, we defined our entrepreneurial culture and our decentralized organization and identified the leadership attributes that had contributed to our success over the years.

We concluded by developing a leadership model with two sets of attributes. The first set included col-



**Airgas' Puritan Medical Products, which focuses on the medical market, has developed and deployed more than 30,000 lightweight Walk O<sub>2</sub> Bout portable oxygen systems.**

laboration, flexibility, integrity, and communication. This set relates to our people and our customers. The second set included vision, entrepreneurship, accountability, and prioritization. This second set of attributes focuses on our business performance.

We are now using this model as a basis for leadership training of the next group of up to 300 managers. We originally structured our business to help customers find solutions at the local level and we think this type of leadership training is a good way to preserve and promote that philosophy.

**GWD:** *Airgas' earnings are up a staggering 24 percent in a bleak economy. How was this feat accomplished?*

**McCausland:** Our financial performance was the result of several factors. The successful acquisition and integration of the Air Products business, as well as the favorable interest rate environment provided much earnings momentum. We also experienced considerable growth in strategic product areas like bulk, specialty and medical gases. The growth in these areas helped offset the sales decline at customers directly linked with the weak industrial economy. We have not had a negative same-store sales number for gas and rent in more than eleven years, whereas our hardgoods same-store sales have been negative for ten quarters. Our broad customer base and the fact that no one customer represents more than 1 percent of sales provide a fair amount of stability regardless of the economic cycle.

**GWD:** *What do you see is the overall direction of the gases and welding industry as a whole?*

**McCausland:** Unfortunately, the economy is not helping us a lot. I haven't seen it this bad since I entered the industry in 1976. Non-technology industrial production, which started to show some signs of life reversed direction in June

and went down 1.6 percent. Manufacturing jobs dropped from more than 19 million to just over 16 million in the last three years. Welding



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hardgoods sales have followed that trend. When the economy does return, we expect to see an uptick in hardgoods. The number of customers Airgas has is growing, although these customers continue to buy less as they experience the same economic pressures as everyone else. In short, I think that because of lack of demand and continued cost pressures, we will see more consolidation.

**GWD:** *What technological advances in medical and specialty gases do you see on the horizon?*

**McCausland:** We are doing well with our portable cylinder oxygen systems in hospitals and nursing homes and we are leasing Walk O<sub>2</sub> Bouts through our Puritan Medical and Airgas locations. We are also providing a service called Puritan Plus, providing delivery logistics for homecare distributors. These are two examples where there has been somewhat of a shift in the business model to meet the changing needs of the medical gas user. We have a focused medical group in Puritan and we are going to leverage that capability across the company.

In the specialty gas market we are building a world-class infrastructure. The acquisition of Air Products' business in 2002 gave us a specialty gas equipment center that strengthened our capabilities in that area. Additionally, 20 of our 52 spec gas labs have ISO 9001:2000 certification and our specialty gas equipment division is an innovator in equipment and equipment assembly.

**GWD:** *How would you describe the impact of the war in Iraq and the war on terrorism?*

**McCausland:** It affects us only to the extent that the war has impacted the economy, and the economy impacts us. The war on terrorism has helped our safety business a little because we sell protective equipment, and the war in Iraq helped our core business a little because defense spending increased, but these influences are not that great.

**GWD:** *What is at the root of success at Airgas?*

**McCausland:** We've been successful because we focus on being the industry leader in the products and markets we serve, and because we take the long view — we invest heavily in our infrastructure. Beyond that, we have an entrepreneurial culture and an organizational structure that empowers people to get the job done. **GWD**

**Airgas®**